

ST 02-0028-GIL 01/31/2002 SERVICE OCCUPATION TAX

Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred incident to sales of service. See 86 Ill. Adm. Code Part 140. (This is a GIL).

January 31, 2002

Dear Xxxxx:

This letter is in response to your letter dated January 28, 2002. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), which can be found on the Department's website at <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

In your letter, you have stated and made inquiry as follows:

I AM WRITING TO YOUR DEPARTMENT AFTER TALKING TO PERSON ABOUT A TAXING PROBLEM WE ARE HAVING WITH A HEALTH INSURANCE BENEFIT MANAGER CALLED AAA. THIS PROBLEM INVOLVES THE CITY EMPLOYEES PRESCRIPTION PLAN. THE CITY'S PLAN TOOK EFFECT 11-01-01 AT WHICH TIME AAA WAS PAYING ON A COST OF DRUG + DISPENSING FEE + TAX ON COST OF DRUG BASIS. THIS IS THE MANNER IN WHICH ALL INSURANCE PAYORS WORK THEIR PROGRAMS. SO DID AAA FROM 11-01-01 TO 12-12-01 AT WHICH TIME THEY STOPPED PAYING THIS TAX ON THE COST OF THE DRUG. IN TALKING TO AAA, IT SEEMS THEY THINK SINCE THIS INVOLVES THE CITY THESE PRESCRIPTIONS SHOULD BE EXEMPT FROM TAX. THIS PROGRAM INVOLVES THE CITY EMPLOYEES AND NOT THE CITY ITSELF. WE HAVE OTHER PLANS WITH AAA WHICH ARE STILL PAYING THIS TAX. ONLY THE CITY EMPLOYEES PLAN/GROUP IS NOT PAYING TAX ON THEIR PRESCRIPTIONS (SEE ENCLOSED PRINTOUTS). PLEASE SEND ME SOME CORRESPONDENCE IN REFERENCE TO THIS MATTER AND THE SERVICE OCCUPATION TAX.

THANK YOU

Pharmacists who provide prescription drugs to customers are considered to be servicemen under the Service Occupation Tax Act. Retailers' Occupation Tax and Use Tax do not apply to receipts from sales of personal services. Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred incident to sales of service. For your general information we are enclosing a copy of 86 Ill. Adm. Code Part 140 regarding sales of service and Service Occupation Tax.

The purchase of tangible personal property that is transferred to service customers may result

in either Service Occupation Tax liability or Use Tax liability for the servicemen, depending upon which tax base the servicemen choose to calculate their liability. Servicemen may calculate their tax base in one of four ways: (1) separately stated selling price; (2) 50% of the entire bill; (3) Service Occupation Tax on cost price if they are registered de minimis servicemen; or, (4) Use Tax on cost price if the servicemen are de minimis and are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of sales of service. The tax is based on the separately stated selling price of the tangible personal property transferred. If servicemen do not wish to separately state the selling price of the tangible personal property transferred, those servicemen must use the second method where they will use 50% of the entire bill to their service customers as the tax base. Both of the above methods provide that in no event may the tax base be less than the cost price of the tangible personal property transferred. Under these methods, servicemen may provide their suppliers with Certificates of Resale when purchasing the tangible personal property to be transferred as a part of the sales of service. Upon selling their product, they are required to collect the corresponding Service Use Tax from their customers. See 86 Ill. Adm. Code 140.106.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). See, 86 Ill. Adm. Code 140.101(f) enclosed. This class of registered de minimis servicemen is authorized to pay Service Occupation Tax (which includes local taxes) based upon the cost price of tangible personal property transferred incident to sales of service. Servicemen that incur Service Occupation Tax collect the Service Use Tax from their customers. They remit the tax to the Department by filing returns and do not pay tax to suppliers. They provide suppliers with Certificates of Resale for the property transferred to service customers. See 86 Ill. Adm. Code 140.108.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). Such de minimis servicemen may pay Use Tax to their suppliers or may self-assess and remit Use Tax to the Department when making purchases from unregistered out-of-State suppliers. Those servicemen are not authorized to collect "tax" from their service customers because they, not their customers, incur the tax liability. Those servicemen are also not liable for Service Occupation Tax. It should be noted that servicemen no longer have the option of determining whether they are de minimis using a transaction by transaction basis. See 86 Ill. Adm. Code 140.109.

We assume that you sell over-the-counter items subject to the Retailers' Occupation Tax. This being the case, you would not be eligible to elect Option 4, the final method detailed above that involves paying Use Tax to suppliers. We do not know if you meet the requirements necessary to be considered "de minimis" in order to elect the third option for payment of Service Occupation Tax based upon cost price. Other than Option 4, all other methods require payment of Service Occupation Tax and the collection of Service Use Tax from service customers.

If a customer claims an exemption from tax, 86 Ill. Adm. Code 130.2005 and 130.2007 govern. These sections discuss exemptions from Illinois sales tax for qualified nonprofit organizations. Organizations that make application to the Department and are determined to be exclusively religious, educational, or charitable receive an exemption identification number ("E" number). This number exempts such organizations from sales taxes when purchasing tangible personal property in furtherance of their organizational purposes. Exemptions from the Service Occupation Tax include sales of tangible personal property as an incident to sales of service to exclusively charitable, religious, or education organizations and to any governmental body. See 86 Ill. Adm. Code 140.125(h), enclosed.

Sales to the government, where an exemption number is presented, are exempt. However, sales to government employees covered by private insurance are not considered sales to the governmental unit itself and are therefore taxable. We cannot ascertain from the information in your letter who your "customer" is. This information is critical in determining your tax liability. It has been our experience that this determination can only be made after examination of the specific contracts detailing the relationships between plan managers, the government agencies and the pharmacies involved.

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b).

Very truly yours,

Melanie A. Jarvis
Associate Counsel

MAJ:msk
Enc.